Morgan Stanley

INVESTMENT MANAGEMENT

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Morgan Stanley Investment Funds

Indian Equity Fund

ACTIVE FUNDAMENTAL EQUITY | EMERGING MARKETS TEAM | MONTHLY COMMENTARY | 31 DECEMBER 2018

Performance Review

In the one month period ending 31 December 2018, the Fund's I shares returned 0.70% (net of fees)[1], while the benchmark returned -0.13%.

Utilities and consumer staples were the best-performing sectors in the index in December, while information technology and health care were the worst. Our stock selections in health care and information technology were the largest contributors to performance. Our stock selection in industrials detracted from performance.

Market Review

The MSCI India Index (-0.13%) outperformed the MSCI Emerging Markets Index (-2.66%) for the third month in a row in December 2018. Small- and mid-cap indices outperformed the wider benchmarks, but growth underperformed standard benchmarks after two months of outperformance.

Encouragingly, foreign portfolio investors (FPI) remained buyers for the second month in December. In cash, they bought stock worth $476 million but sold $943 million in the futures market. Debt markets saw a second consecutive month of buying, worth $671 million, as the macro indicators for India looked up. Conversely, domestic mutual fund inflows continued to slow while domestic insurance companies remained sellers for the second consecutive month.

The rupee depreciated marginally by 0.3% month-on-month versus the U.S. dollar and 1.0% versus the euro during the month. The U.S. dollar continued to be underpinned by safe-haven demand with investor fears of a global slowdown, the Federal Reserve hike and uncertainty around prolonged geopolitical trade tensions between the U.S. and China.

The Organization of the Petroleum Exporting Countries move to cut oil production by 1.2 million barrels per day in its early December meeting left the markets underwhelmed, and oil prices continued their downward spiral, falling 9% in U.S. dollars per barrel and 9.2% in rupees per barrel, in addition to a sharp decline during the previous month.

Portfolio Activity

There were no significant portfolio changes.

Strategy and Outlook

The end of 2018 saw a definitive strengthening of India's macro scorecard with the softening in oil prices. Also, the soft patch in inflation (Consumer Price Index) continued with the November print declining further to a 17-month low of 2.3%, owing to a broad-based decline across food, fuel and core inflation.

From a policy standpoint, the Reserve Bank of India (RBI) retained the repo rate at 6.5% as well as maintained the policy stance at 'calibrated tightening' in its bi-monthly meeting in December. The dovish tone of the RBI was expected given the consistently low inflation prints and moderating crude prices. RBI Governor Urjit Patel resigned, marking a rare event in the institution's history, with the government announcing former bureaucrat Shaktikanta Das as his successor. The market will keenly watch future government and RBI interactions for signs of the continued independence of the RBI.

Encouragingly, the RBI is focussing more on easing tight liquidity in the banking sector, scaling up its buys through two Open Market Operations (OMO), making the aggregate injection of 500 billion rupees ($7 billion) of durable liquidity for the month of December 2018. The government also sought parliamentary approval for further recapitalization of the state-owned banks with an additional 410 billion rupees (about $6 billion) in order pull some lenders out of the Prompt Corrective Action (PCA) ambit for fiscal 2019 so that they can lend again. This is in addition to the previously declared capital infusion of 1.4 trillion rupees (about $20 billion). This should help cool liquidity concerns in the coming months.

[1] Source: Morgan Stanley Investment Management Limited. Data as of 31 December 2018.

In the latest iteration to the Goods and Services Tax, the GST Council announced a reduction in tax rates on 22 items effective January 1, 2019. Seven were from the highest slab of 28% (six moved to 18% and one to 5%). With the latest tax cuts, only 27 items remain in the highest tax slab of 28%. The idea behind this was to keep only a minimal number of luxury and demerit/sin items in the highest percentage slab. This is positive for consumption going forward.

Politics took the centre stage as India had five of its largest states go to the polls in December. The Opposition Party, the Indian National Congress (INC), emerged victorious, albeit with narrow margins, in the three states of Madhya Pradesh, Rajasthan and Chhattisgarh with an incumbent Bharatiya Janta Party (BJP, the ruling party) Government. Telangana and Mizoram resulted in regional party domination. While a loss of three states is sentimentally negative for the ruling party, it is important to keep in perspective that the State Election outcomes do not affect the continuity of the Central Government, and are usually contested more on local issues. Also, the BJP was in power in Madhya Pradesh and Chhattisgarh for the past 15 years, while the state of Rajasthan has a history of anti-incumbency and keeps flipping power between INC and BJP. Vote share for the BJP and INC remained neck and neck in the larger states of Madhya Pradesh and Rajasthan, so the consensus for the National/General elections due in May 2019 remains a return to power for the BJP with a reduced majority.

The high-frequency indicators are showing interesting inflections. Economic activity in November moderated, led by the slowdown in foreign trade, freight and energy consumption. Auto trends too remained mixed, with rising crude prices. Interestingly, the key positives in the month were the improvement in capacity utilization (best level in 18 quarters in the second quarter of fiscal 2019), increase in inward remittances (highest flow ever at $19.5 billion), improvement in credit growth to 15% and moderate inflation. We continue to closely monitor the growth spots and invest accordingly.

For further information, please contact your Morgan Stanley Investment Management representative.

FUND FACTS

Launch date	Base currency	Index
30 November 2006	U.S. dollars	MSCI India (Net) Index

12 Month Performance Periods to Latest Month End (%)

	DECEMBER '17 - DECEMBER '18	DECEMBER '16 - DECEMBER '17	DECEMBER '15 - DECEMBER '16	DECEMBER '14 - DECEMBER '15	DECEMBER '13 - DECEMBER '14
MS INVF Indian Equity Fund - I Shares	-20.24	41.65	2.69	-0.30	44.34
MSCI India (Net) Index	-7.30	38.76	-1.43	-6.12	23.87

Past performance is not a reliable indicator of future results. Returns may increase or decrease as a result of currency fluctuations. All performance data is calculated NAV to NAV, net of fees, and does not take account of commissions and costs incurred on the issue and redemption of units. The sources for all performance and Index data is Morgan Stanley Investment Management. **Please visit our website www.morganstanley.com/im to see the latest performance returns for the fund's other share classes.**

Share Class I Risk and Reward Profile

Lower Risk						Higher Risk
1	2	3	4	5	**6**	7
Potentially Lower Rewards						Potentially Higher Rewards

The risk and reward category shown is based on historic data.

- Historic figures are only a guide and may not be a reliable indicator of what may happen in the future.
- As such this category may change in the future.
- The higher the category, the greater the potential reward, but also the greater the risk of losing the investment. Category 1 does not indicate a risk free investment.
- The fund is in this category because it invests in shares of Indian companies and the fund's simulated and/or realised return has experienced high rises and falls historically.
- The fund may be impacted by movements in the exchange rates between the fund's currency and the currencies of the fund's investments.

This rating does not take into account other risk factors which should be considered before investing, these include:

- The fund relies on other parties to fulfill certain services, investments or transactions. If these parties become insolvent, it may expose the fund to financial loss.
- There may be an insufficient number of buyers or sellers which may affect the funds ability to buy or sell securities.
- There are increased risks of investing in emerging markets as political, legal and operational systems may be less developed than in developed markets.
- Past performance is not a reliable indicator of future results. Returns may increase or decrease as a result of currency fluctuations. The value of investments and the income from them can go down as well as up and investors may lose all or a substantial portion of his or her investment.
- The value of the investments and the income from them will vary and there can be no assurance that the Fund will achieve its investment objectives.
- Investments may be in a variety of currencies and therefore changes in rates of exchange between currencies may cause the value of investments to decrease or increase. Furthermore, the value of investments may be adversely affected by fluctuations in exchange rates between the investor’s reference currency and the base currency of the investments.

Please refer to the Prospectus for full risk disclosures. All data as of 31 December 2018 and subject to change daily.

INDEX INFORMATION

The **MSCI India Index** is designed to measure the performance of the large and mid cap segments of the Indian market.

The **MSCI Emerging Markets Index (MSCI EM)** is a free float-adjusted market capitalization weighted index that is designed to measure equity market performance of emerging markets.

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